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Overview of the Japanese Market for Consumer-Ready Agricultural Products, 1998

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Report Highlights:

Imports of consumer-oriented food products (excluding seafood) from the U.S. were down 9.7% to \$5.9 billion (import-CIF-basis) in 1997. Although retail sales at supermarkets and department stores continued to decline in 1997, an ongoing revolution in retail distribution is dramatically affecting the relationships among manufacturers, and true price competition has emerged to meet consumer demands for lower prices. Moreover, Japan's large and diverse food service industry is a prime target for U.S. exporters of food, beverage, and seafood products. Within Japan's \$355 billion food service market, the number of restaurants serving Western-style meals continues to grow. Products in demand include beef, pork, chicken, vegetables, wine, and seafood products. In 1997, several key food service and retail entities began capitalizing on the growing market for Home Meal Replacements (HMR) by developing HMR/take-out concepts and menus, thus blurring the lines between retail and food service. For U.S. food exporters with cost-competitive and high-quality products, this adds up to tremendous opportunities for exports of high value, value-added products to Japan.

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I. GENERAL MARKET OVERVIEW

A. THE MACROECONOMIC SITUATION

Japan is America's largest overseas trading partner. It is also the world's second largest economy with a gross domestic product (GDP) of roughly \$4.2 trillion in 1997. That is 70 percent of the United States' GDP, while Japan has only half the population of the U.S. Japan's economy is larger than that of Germany, the United Kingdom and France combined, and is ten times the size of China and 17 times the size of India. U.S. exports to Japan exceed our exports to China, Taiwan, Hong Kong and Singapore combined. Japan represents almost three-quarters of the entire Asian economy.

In the 1990's, however, Japanese economic growth has been decidedly sluggish, as the economy continues to experience a broad-based restructuring from a configuration that emphasized manufacturing to one that facilitates efficient service industries, and a financial sector that continues to dig its way out from the after-effects of the late-1980's asset-price "bubble." The substantial fiscal stimulus package announced by the ruling Liberal Democratic Party on April 24, 1998 -- with temporary tax cuts and spending measures amounting to 2.4 percent of GDP, more than reversing a planned fiscal contraction -- should be sufficient to keep the Japanese economy from falling into a deeper recession in the immediate term. But at the same time, Japan's financial sector woes and ongoing industrial restructuring mean that the recovery will be gradual -- and possibly short-lived absent additional measures to accelerate economic reform and growth in 1999 and beyond. The nascent growth cycle of 1996, when swelling corporate profits (largely due to growing exports and an initial round of corporate restructuring) fueled both strong business investment and solid growth in personal income, has evaporated. Consumer and business sentiment will now need to improve significantly before a self-reinforcing growth cycle can be re-established.

The marked depreciation of the yen since mid-1995 has resulted in slowed import growth and accelerated export growth. At the same time, however, as the need to cut costs has become increasingly severe, long-term *keiretsu* (subsidiary) supplier relationships have been reexamined, and manufacturers have begun to look for ways to bring in high-quality, low-cost components and materials from foreign suppliers. Should such developments continue, overseas suppliers will see new opportunities in some areas of the Japanese market, although they will be challenged to supply products at competitive prices. Successful implementation of the Japanese Government's JFY 95-97 Deregulation Action Program will also aid foreign traders. (Country Commercial Guide)

B. ECONOMIC SITUATION AND CONSUMER-READY FOOD PRODUCTS

While Japan's total imports of agricultural, food, fish and seafood, and forestry products in JCY 1997 decreased approximately \$5.5 billion in dollar terms from the previous year, Japan's imports of the same products in yen terms increased by ¥200 billion. The slowdown in import growth was attributable primarily to the declining value of the yen, low consumer confidence, lower commodity prices, and the decline in imports of pork, poultry, and seafood products. The yen's average annual value depreciated nearly 10 percent-- from ¥108.81 per dollar in CY 1996 to ¥120.92 per dollar in CY 1997. Japan's imports of agricultural, food, fish and seafood, and forestry products in CY 1997 from all sources were \$66.6 billion, down 7.7 percent from the previous year. Imports from the United States decreased by \$2.6 billion, from \$20.6 billion to \$18 billion.

1. GENERAL MARKET FORCES

Over the past few years, the convergence of socioeconomic forces of deregulation, internationalization, and a prolonged economic recession have broken traditional economic and social relationships in Japan at an unprecedented pace. These factors have revolutionized retail distribution and are dramatically affecting the relationships among manufacturers, as true price competition has emerged to meet consumer demands for lower prices. For U.S. food exporters with cost-competitive and high-quality products, this adds up to tremendous opportunities for exports of value-added products to Japan.

The main socioeconomic changes driving the recent market developments are as follows:

- 1) Bursting of the Japanese bubble economy and subsequent recession
- 2) Domestic deregulation
- 3) Changes in consumer attitudes, including increased consumer demand for value

1) Bursting of The Japanese Economic Bubble And Subsequent Recession

During the mid to late 80s, an unsustainable spiral of growth in land and stock values was created by reckless investment speculation, which in turn was fueled by a loose money supply and an official discount rate that reached a post-war low (2.5% from February 1987 to May 1989). Metropolitan land prices and stocks roughly tripled in value between January, 1985 and December, 1989, causing a surge in both corporate and consumer spending. However, a steep decline in stock values in 1990 (from a peak in December 1989) and an increase in the official discount rate brought to a halt corporate and consumer spending sprees. The result has been one of the longest recessions since the end of World War II.

2) Deregulation

Due to intensifying foreign pressure to open the Japanese market to foreign goods and services, the Japanese government has enacted and is continuing to propose deregulation measures, shifting the balance of price decision-making power from manufacturers to retailers. By benefitting large retailers, deregulation is speeding up the pace of rationalization within the distribution sector. Relaxing the Large-scale Retail Stores Law, easing liquor licensing restrictions, and stepping up enforcement of the anti-trust laws have all had a major impact on retail distribution.

As larger retail outlets have spread in Japan, the regulation of "large stores" has become ever more of a concern. On May 27, 1998, the Diet passed the Large-Scale Retail Store Location Law. This law will be implemented in the year 2000, and will replace the current Large-Scale Retail Store Law. Whereas the current law (administered by the Ministry of International Trade and Industry (MITI) on the basis of input from various concerned parties) focuses on the competitive effects of large-store openings, the new law is intended to give local authorities the power to regulate new large stores on the basis of environmental considerations only. MITI has made clear its intent to draft guidelines specifying the environmental standards to be used, so that the new law will be applied with reasonable uniformity by all localities. The current law will be applied to new large store applications until the new law is implemented. Thereafter, the new law will apply both to new store openings and to significant changes in the business operations of existing stores (such as an expansion of floor space or an extension of business hours). Changes include: 1) shortening the period required for coordination and processing of new store outlet requests; 2) liberalization of outlets with a floor area of 1,000 square meters or less; 3) extending closing times from 7 p.m. to 8 p.m.; and 4) shortening the minimum number of annual holidays from 44 days to 24 days. These changes have

made it much easier for large store chains to launch new outlets.

Changes to the liquor law have opened up liquor retailing to large retailers. Previously, the number of liquor licenses in any given area was restricted. Now, any retail store with 10,000 or more square meters of retail space automatically qualifies for a liquor license, opening the market to large supermarket chains for the first time.

3) Changes in Consumer Attitudes: Increased Demand for Value

More than ever, consumers are demanding value for their money. The collapse of the bubble economy in 1991, which put a halt to growth in household incomes, has forced Japanese consumers to tighten their budgets. Although the Japanese are still among the world's most quality-demanding consumers, today's consumers are much more accustomed to making rather complex judgments about the value they are receiving at a given price. The ongoing economic slump worsened slightly in 1997, causing Japanese consumers to continue placing a high priority on lower prices.

However, consumer demand is not only focused on price, but on health, safety, and personal preference as well. Striking similarities between Japanese and U.S. consumer trends point towards an emerging capacity for U.S. food and agricultural enterprises to produce for the Japanese market. In this regard, both the U.S. and Japanese food markets are experiencing a convergence of three trends in consumer preference: convenience, health and technology, and quality (see section on Consumer Selection Criteria for Food).

2. CHANGES IN RETAIL DISTRIBUTION

The convergence of the socio-economic forces discussed above have brought about intense pressure on retailers to lower prices while maintaining quality levels. Faced with the need to cut costs and lower retail prices for their very survival, large retailers, led by national supermarkets and discount stores, have responded with major innovations in the way they do business. Some of these innovations are listed below.

1) Lowering Prices through Product Development:

To offer lower prices, national supermarkets have undertaken their own product development in terms of private label brands, especially those manufactured abroad. Retailers are no longer accepting prices offered by domestic suppliers and are actively working to source products at prices that will meet consumer expectations.

2) Lowering Prices through Streamlining Operations:

National supermarkets and discount stores are cutting layers off their distribution system to lower prices by by-passing wholesalers and purchasing directly from domestic manufacturers and foreign suppliers. They are also squeezing out inefficiencies in their procurement operation by purchasing large volumes on a no-return basis and doing away with just-in-time delivery systems.

3) Lowering Prices through Pressure on Manufacturers and Wholesalers:

National supermarkets are now actively offering year-round discounts and are demanding and receiving lower

wholesale prices for domestically produced products.

4) Securing supply by direct contract with livestock and fresh produce producers:

Despite strong cost-consciousness due to a sluggish economy, consumers are also very interested in product origin, safety, freshness, and quality. Not only national supermarkets but also regional and mid-sized supermarkets are actively working to obtain contracts with farms and producers — mainly domestic but in some cases foreign — in order to secure high-quality, fresh produce and livestock products. This is viewed as a way for regional supermarkets to strengthen their position among the competition.

In sharp contrast to the robust growth experienced by national supermarkets and discount stores in the new, more liberalized retail structure, traditional department stores and so-called mom 'n pop stores are experiencing sharp declines. Department stores, which traditionally do not offer discounts, have recorded continuous declines in sales since March of 1992, while the small mom 'n pop stores are experiencing a long downward slide. The mom 'n pop stores cannot hope to match the prices of large retailers and can no longer expect to compete successfully in areas such as freshness and convenient locations.

3. FUTURE OF THE RETAIL/WHOLESALE SECTOR

The trend in consumers' new found appreciation for value will continue; consumer demand for high quality at reasonable prices will gain even more strength as they become more and more accustomed to shopping around for the best prices. This will increase the pressure on retailers to develop products at prices that meet consumer demand, to increase more global sourcing, to lower prices by trimming layers off their distribution system (i.e., by-passing wholesalers), and to streamline their operations.

Supported by deregulatory measures, national supermarkets will continue to lead the trend to provide better value in food products to consumers. They have the purchasing power and operational capabilities to demand lower prices without compromising quality.

These stores will also expand their retail power even further by establishing larger and more efficient stores, including the establishment of "hypermarts." Hypermarts are mega-discount supermarkets, sparsely decorated and staffed in order to minimize initial investments and trim operating costs. Furthermore, as more and more consumers shop around for cheaper prices, the need for road-side shopping centers and large discount stores in suburban areas has been increasing.

As the number of women entering and staying in the work force increases, convenience is becoming a major purchasing criterion for food products. Demand for products which cut down on cooking time, such as frozen foods, microwave foods, those in retort pouches, and Home Meal Replacements (HMR) are expected to experience even stronger growth.

Compact, modern convenience stores, which have long hours of operation and handle all kinds of everyday necessities, have spread like wildfire throughout Japan during the past ten years. By adding and reinforcing more services including ticket reservations, processing payment of public utility bills, and fast food service, convenience stores will continue to be an important part of the emerging structure of retail distribution. The major chains are

all subsidiaries of large national retail chains or wholesalers (e.g., Lawson's parent company is Daiei; 7-Eleven, Ito-Yokado; FamilyMart, Seiyu; Mini-Stop, Jusco). As a result of this relationship, products can be obtained through their parent company's procurement system. Distribution systems for these chains are well developed and efficient. Therefore, little structural change will occur in this sector, other than rapid growth. In order to modernize and remain in the retail business, some mom 'n pop stores are becoming franchises for convenience store chains, taking advantage of this sector's high growth.

C. TRADE RESTRICTIONS

The U.S. Government continued to make progress in 1997 on improving market access for U.S. exports of goods and services into Japan, Asia's largest economy. While Japan's economic stagnation depressed imports, resulting in an increase in Japan's current account and global trade surplus, it also presented an opportunity to press the Japanese Government to address long-term, structural impediments to market access for U.S. goods and services. The United States concluded new agreements and resolved disputes with Japan in several important sectors which will offer significantly expanded opportunities for U.S. exports to Japan. The most comprehensive of these agreements was the Enhanced Initiative on Deregulation and Competition Policy, announced by President Clinton and Prime Minister Hashimoto in June, 1997. Other bilateral agreements or settlements concluded during the past year addressed barriers affecting: wood products, sound recordings, tomatoes, telecommunications procurement, maritime and port practices, distilled spirits, and civil aviation.

Japan's recent government deregulation efforts notwithstanding, the Japanese economy is characterized by excessive, outdated regulations. Unnecessary regulations restrain economic growth, raise the cost of doing business in Japan, lower the standard of living for Japanese consumers, and impede imports. Japanese economists estimate that the government regulates about 40 percent of all economic activity in Japan. Examples of excessive regulation include price controls, unique standards, and burdensome testing and certification requirements. The Japanese Government estimates that if its deregulation plans are fully implemented, from JFY 1998-2003 the Japanese GDP would grow by an additional 0.9 percent annually, while the ratio of current account surplus to GDP would decline 0.9 percent.

Regulations lie at the heart of many of the market access problems faced by U.S. companies doing business in Japan. Some regulations are aimed squarely at imports; others are part of a system which protects the status quo against new market entrants, therefore disproportionately affecting foreign firms. The United States Government has aggressively pushed for elimination of regulations which impede market access for U.S. companies, and many recent U.S.-Japan trade agreements have addressed issues related to the regulation of Japanese markets. (National Trade Estimate Report 1998)

At the same time that Japanese agricultural production is in decline, access for imported agricultural products has never been better. Due to persistent negotiation by the United States and others throughout much of the 1980s and 1990s, Japan has eliminated many of the agricultural market access barriers for which it was once famous. Where earlier quotas and outright bans restricted the market for U.S. beef, citrus, fruit juice, cherries, apples and ice cream, all of these markets have now been opened. Market access remains limited in a few key commodities, such as rice which remains under quota; tariffs remain high on a number of high value added processed food products; and some technical problems remain concerning food additives as well as phytosanitary barriers on a number of fruits and vegetables. However, these exceptions aside, the Japanese market is, contrary to popular belief, substantially open to U.S. food and agricultural products.

The combination of this radically improved market access and declining domestic production has resulted in phenomenal export growth potential for U.S. agriculture. 1997 imports of U.S. agricultural/forestry and fisheries products amounted to \$18.0 billion, down from 1996 due to the yen's depreciation and food safety scares that reduced demand for beef and other meat imports.

II. THE CONSUMER

A. DEMOGRAPHIC CHANGES

The growth rate of the Japanese population continues its steady decrease. More and more women are marrying later, choosing to limit the number of children to raise, and pursuing career opportunities. Currently, the average birth rate per woman is less than 1.5 children.

A societal trend taking place in Japan today will have a profound impact on Japan in the years to come. Japan's population is rapidly aging -- a "greying" of the society. By the year 2025, the Ministry of Health and Welfare predicts that more than one of every four Japanese will be 65 or older (up from the current rate of one in every seven). In just one quarter-century, Japan will have gone from having the fewest elderly as a percentage of its population to having the highest percentage among all industrialized nations.

B. HOUSEHOLD LIVING AND FOOD EXPENDITURE

According to Japanese sources, household spending took its biggest yearly fall in JFY 1997 as the consumption tax increase in April 1997 made consumers hesitant to buy. Household spending averaged ¥330,987 (\$2,735)* per month in the fiscal year that ended March 31, down 2.1 percent on an inflation-adjusted basis from the previous year. Japan's Management and Coordination Agency said the decline was the largest since the agency began compiling the statistics under the current method in fiscal 1963. The drop is mainly due to the consumption tax increase and uncertainty over future income levels following major business failures since November 1997. The government raised the consumption tax from 3 percent to 5 percent on April 1, 1997, which economists say has kept consumers reluctant to spend after going on a buying binge before the tax hike.

By product category, Japanese households spend a relatively large percentage of their income on food in comparison to other industrialized countries. Expenditure for food products reached \$8,540 in 1997 and accounted for nearly 20%, the second largest share of household expenditure behind housing.

Since 1991, food expenditure has been on a downward slide due mainly to declining consumer prices and active attempts by consumers to shop at less expensive stores. Annual household food expenditure declined slightly by 3% in 1997. Combined, meat and seafood accounted for 21%, the largest share of Japanese household food expenditure (equivalent to over \$1,663 in 1997). Fruit and vegetables accounted for approximately 17% of household food expenditure (approximately \$1,296 in 1997), while dining out accounted for 17% (approximately \$1,302 in 1997).

The number of meals Japanese consumers eat outside the home and the percentage of the food budget spent on dining out has increased steadily over the past thirty years. Japanese spent approximately 46 percent of their total food dollar eating out in 1996, up from 30 percent in 1976. On a per capita basis, annual eating out expenditures totaled \$1,302 in 1997.

A variety of demographic and economic factors are fueling the trend toward increasing consumer spending on eating out:

- Increase in the Number of Working Women
- Smaller Households and More Single Person Households
- Menu Diversification

C. CONSUMER PURCHASE BEHAVIOR

Consumer spending in Japan is reflecting a more on-the-go lifestyle in which glamour and excitement appear to be taking precedence over more practical ways. According to a GOJ report, fiscal 1997 sales increased in food catering services, gardening goods, health and cosmetic supplies, sporting goods and toys, compared to the previous survey for 1994. What's more, all those items also had increased in fiscal 94 over fiscal 1991. On the other hand, the triennial report on wholesale and retail businesses shows that sales of foodstuffs such as rice, vegetables, beef, and fish declined in 1994 and 1997 compared to the previous surveys.

According to the Ministry of International Trade and Industry, the sales drop in a broad range of practical items partly reflects the so-called "price destruction" — a drastic fall in prices — amid growing imports of inexpensive products. However, the Ministry said that the overall result of the latest survey reflects the changing lifestyle of Japanese people, who, for instance, are increasingly inclined to patronize catering services rather than cook for themselves. According to the report, Catering services such as pizza and boxed lunch deliveries went up 21.4 percent in 1997 over the 1994 figure. The report also shows that the presence of parking lots is becoming an important factor during shopping; annual sales for shops with parking lots went up an average of 10.5 percent over the past three years while those without parking lots saw only a 0.7 percent increase.

Until recently, most consumers shopped using public transportation or bicycles, which kept them bound to stores near their homes when purchasing everyday necessities such as food limited the volume of goods purchased at any one time. This meant consumers had to shop on nearly a daily basis for food products. However, deregulation and increased consumer demand for lower prices has led to a boom in suburban construction of new, larger, and more efficient stores and shopping centers with large parking facilities. These new stores take advantage of the lower land prices in suburban areas and greater on-site storage lowers costs and, subsequently, retail prices. Consumers are now able to shop around for better prices on weekends by car and stock up on lower-priced products.

D. SELECTION CRITERIA FOR FOOD

Both the U.S. and Japanese food markets are experiencing a convergence of three trends in consumer preference: 1) convenience, 2) health and technology, and 3) quality.

1) Convenience

Japanese consumers desire take-home meals that require little or no preparation, offer variety, and are cost effective.

The number of women entering and staying in the work force is increasing. More and more women are marrying later, choosing to limit the number of children to raise, and pursuing career opportunities. At the same time, the number of unmarried men is rising. Opting for the bachelor's life, a rising percentage of "salary men" do not have a meal waiting for them when they come home. Meanwhile, the Japanese population is aging at an alarming pace, due to the low birth rate and the highest life expectancy in the world (Ministry of Health and Welfare estimates, 82.8 years for women, 76.4 years for men). Just like their younger counterparts, more and more elderly Japanese are frequenting convenience stores or rely on supermarket take-home meals. All this translates into a society becoming increasingly dependent on convenience foods.

2) Health and Technology

In the wake of global outbreaks of *E. coli* in 1996, food safety has come to the forefront of food-service industry concerns. In response, Japanese consumers have sought refuge in domestically produced and distributed food, believing it to be fresher/safer than that from the "outside." All sectors of U.S. agriculture must invest in clearly communicating to the Japanese consumer the technological and philosophical leadership worldwide of U.S. food safety systems, with particular attention to impact on consumer confidence in overall quality control, hence product quality. The credibility of quality depends on scientific and technological HACCP¹ systems "from farm to fork", with particular attention to delivery, handling, and preparation systems. As the Japanese still are generally misinformed about U.S. food safety systems, "food safety misinformation management" will be the challenge to meet. As an example, the current organics boom in Japan reflects consumer insistence on safety. The mad rush for reliable sources of safe food creates a market opportunity to the extent that the world leadership enjoyed by the U.S. food system with regard to safety and quality can be clearly articulated to the Japanese consumer.

3) Quality

Consumers want convenience food that does not compromise quality; in other words demand is for high-quality fast food. Home Meal Replacements (HMR) -- wholesome, restaurant-quality meals for those with little time or will to cook -- are beginning to address this need. Ultimately, HMRs should convey the image that the meal is coming straight from the farm to the dinner table, delivering the three key component parts of food quality: taste, nutrition, and safety.

III. U.S. MARKET POSITION

A. DOMESTIC COMPETITION

Japanese agricultural production is steadily contracting on a year-by-year basis, with key sectors seeing a decrease in production in most years. Cereals, rice, dairy, beef, pork, fruits, and vegetables are all sharing this decline to

¹ Hazard Analysis and Critical Control Points: a program requiring plants to identify critical points in their processing systems where contamination can occur, with audited controls to prevent or reduce contamination.

greater or lesser degrees. Efficiency is hampered by the small and scattered nature of farm lands and by inordinately high input costs. Farmers are limited by the government and the cooperative system in their ability to make decisions regarding production, pricing and marketing. However, producers are increasingly using "fresh" and "natural" to sell their products to Japanese consumers who have deep concerns about the safety of imported food products.

The very factors that make Japan a huge market for the United States also make it a giant market for Japan's own food processing sector. With a population of some 126 million people earning incomes higher than that of U.S. citizens, and with an enormous industrial base, Japan has developed a very large and sophisticated agricultural processing industry to serve its home market. As in other sectors of the Japanese economy, the food processing industry has benefitted from sophisticated management and first- rate technology. With vast distribution networks and established brand awareness, domestic food producers hold several advantages over foreign competition. Further, domestic processors appreciate the importance of packaging and invest heavily in top quality design, printing and materials. Perhaps their greatest advantage over foreign competition is a deep understanding of consumer needs and a willingness and ability to respond promptly to emerging trends.

B. THIRD-COUNTRY COMPETITION

JAPAN'S IMPORTS OF CONSUMER-ORIENTED AGRICULTURAL PRODUCTS					JCY (April-March) 1997/96
Country	1996 Value \$ Million	1996 Share	1997 Value \$ Million	1997 Share	Growth Rate for Value
U.S.	6,552	30.0%	5,918	29.9%	-9.7%
China	2,576	11.8%	2,452	12.4%	-4.8%
Australia	1,740	8.0%	1,736	8.8%	-0.2%
Thailand	998	4.6%	905	4.6%	-9.3%
Others	9,983	45.7%	8,757	44.3%	-12.3%
TOTAL	21,849		19,768		-9.5%

JAPAN'S IMPORTS OF FISH AND SEAFOOD PRODUCTS

Country	1996 Value \$Million	1996 Share	1997 Value \$Million	1997 Share	1997/96 Growth Rate for Value
China	2,124	12.7%	2,240	14.7%	5.5%
U.S.	2,100	12.6%	1,654	10.8%	-21.2%
Thailand	1,239	7.4%	1,146	7.5%	-7.5%
Indonesia	1,196	7.2%	1,125	7.4%	-5.9%
Russia	1,201	7.2%	1,030	6.7%	-14.2%
others	8,826	52.9%	8,078	52.9%	-8.5%
TOTAL	16,686		15,273		-8.5%

(Ministry of Finance)

Japan's imports of agricultural, food, fish and seafood, and forestry products in CY 1997 from all sources were \$66.6 billion, down 7.7 percent from the previous year. Imports from the United States decreased by \$2.6 billion to \$18 billion. The U.S. was the leading supplier with \$18.0 billion or 27.1 percent of the market (nearly three

times the share the nearest competitor), with China second with 9.8 percent, Canada third with 7.8 percent, Australia fourth with 6.4 percent and Indonesia fifth with 5.5 percent (displacing Thailand, the fifth largest in CY 1996). Consumer-oriented products imported from the U.S. with category values of more than \$100 million and that showed increases included (percent increase): dairy products (9.8 percent) and pet food (0.5 percent). In addition, imports of rice from the United States increased to \$168 million, an increase of 20.9 percent from the previous year.

Agricultural imports from China continued to grow as its import market share increased to 9.8 percent. The year-to-year growth in product categories exceeding \$100 million occurred in peanuts, prepared/preserved meats, lumber, other wood products, live fish, fish fillets and meats, mollusks, and other fish and seafood products.

Canada was the third largest supplier of agricultural products to Japan with \$5.2 billion or 7.8 percent import market share. The largest category was lumber at \$2.0 billion (5.3 percent decrease from the previous year), followed by canola at \$625 million, wheat at \$381 million, pork at \$290 million, and crustaceans at \$271 million.

The fourth largest supplier of agricultural products to Japan is Australia with \$4.3 billion or 6.4 percent, including \$963 million for beef, \$573 million for other wood products, \$284 million for wheat, \$230 million for dairy products, \$158 million for cotton, and \$154 for pet food.

Indonesia rounds out the list of the top five suppliers of agricultural, food, wood and seafood products to Japan with \$3.7 billion, with nearly two-thirds wood products (\$2.1 billion). Crustaceans provide \$747 million of the \$1.1 billion of seafood imports. Indonesia surpassed Thailand, whose share fell to 4.7 percent, totaling \$3.1 billion. Thailand's primary agricultural export to Japan is seafood.

U.S. MARKET POSITION IN JAPAN FOR AGRICULTURAL FOOD IMPORTS

	U.S. Share	Change in U.S. Market Position (Value) U.S. Share ÷ Nearest Competitor Share (**Point loss or gain in market share)			
		1997	1996	**97\96	Competitor
CONSUMER-ORIENTED	1997	1997	1996	**97\96	Competitor
Cherries	99.5	248.8	198.8	50	New Zealand
Broccoli	97.7	75.2	46.3	28.9	Australia
Almonds	96.9	35.9	32.1	3.8	Australia
Lemons	91.1	21.7	28.6	-6.9	Chile
Frozen Potatoes	85.9	8.0	8.4	-0.4	Canada
Oranges	84.5	11.3	8.3	3	South Africa
Frozen Sweet corn	80.0	4.4	4.8	-0.4	New Zealand
Grapefruit	79.0	6.8	5.9	0.9	Israel
Dried Fruit	78.8	6.5	7.1	-0.6	China
Soft Drinks	79.9	20.0	9.1	10.9	China
Eggs/Powdered eggs	71.4	8.9	9.2	-0.3	Thailand
Beer	58.7	4.2	5.5	-1.3	Holland

Sausage	66.1	5.0	5.8	-0.8	Denmark
Beef Jerky	68.1	4.7	3.9	0.8	Australia
Beef	58.7	1.6	1.8	-0.2	Australia
Ice cream	58.1	1.6	2.2	-0.6	Australia
Fruit (fresh/refrigerated)	45.6	1.7	1.8	-0.1	Philippines
Onions	63.3	3.7	2.1	1.6	New Zealand
Frozen Vegetables	41.2	1.4	1.4	0	China
Prepared glutinous rice products	35.0	0.9	1.1	-0.2	Thailand
Pet Food	36.4*	1.3	1.3	0	Thailand
Frozen Fruit	38.9*	1.6	1.7	-0.1	China
Processed meat products	34.6*	1.4	1.7	-0.3	Thailand
Fruit Juice	35.8*	1.4	1.4	0	Brazil
Nuts	30.0	0.8	0.9	-0.1	China
Chocolate candy	25.3*	2.0	2.2	-0.2	Belgium
Peas and Beans	24.8	0.6	0.8	-0.2	China
Processed Tomato	22.6	0.9	1.2	-0.3	Italy
Orange Juice	25.5	0.4	0.4	0	Brazil
Asparagus	22.7	0.9	1.1	-0.2	Philippines
Biscuit/Cracker	26.9*	2.1	1.8	0.3	Denmark
Vegetables (fresh/refrigerated)	24.7	0.8	0.8	0	China
Apple Juice	26.0*	1.4	1.8	-0.4	Australia
Pork (including offals)	28.8	0.9	0.5	0.4	Denmark
Processed Vegetables	21.8	0.5	0.5	0	China
Whiskey	20.1	0.3	0.3	0	England
Dairy Products	16.0	0.8	0.7	0.1	New Zealand
Processed Cereal Products	13.6*	1.1	1.2	-0.1	Australia
Red bean (azuki)	7.3	0.1	0.2	-0.1	China
Dried Vegetables	8.4	0.1	0.9	-0.8	China
Mineral Water	8.0	0.1	0.6	-0.5	France
Wine	5.8	0.4	0.4	0	Italy
Macaroni/Spaghetti	3.5	0.0	0.5	-0.5	Indonesia
Peanut (processed)	1.3	0.2	0.7	-0.05	China
	US Share	Change in US Market Position**			
FISH AND SEAFOOD PRODUCTS	1997	1997	1996	97\96	Competitor
Frozen cod surimi	89.0	9.7	7.3	2.4	Russia
Salmon roe	68.8	3.9	5.7	-1.8	Denmark

Sea urchin	53.9	3.1	4.6	-1.5	Chile
Salmon/Trout	26.1	1.4	1.6	-0.2	Chile
Crab	11.5	0.6	0.7	-0.1	Canada
*Market Share Leader (Source: Ministry of Finance)					

Japan imported 34.4% more wine in 1997 than in the previous year, according to statistics released by the Japan External Trade Organization (JETRO). Fueled by a boom in the popularity of wine, imports rose to 147,000 kiloliters in 1997 after remaining flat during the previous year. Imports of all beverages, including alcohol products, declined 2.6% in 1997, to \$2.11 billion. Beer imports dropped 32.8%, while whiskey imports inched up by 1%. Only imported wine bucked the trend, showing growth of 27.2% in dollar terms. As for U.S. wine exports to Japan, overall growth in value market share has been flat since 1995, as the U.S. continued to hold 6% of the value market from 1995-1997 (6.7% in 1997). On a volume basis, the U.S. increased by nearly 2% its share of the market, from 13% in 1996 to 14.7% in 1997. While it is said that Japan's wine market is booming, the U.S. is being outpaced by traditional European suppliers and new competitors such as Australia, Chile, and South Africa.

In order to stay ahead of the competition, U.S. producers have to make a bigger effort to know the Japanese needs and work to give these important customers what they want. Those U.S. companies that try to export their products to Asia need to work hard to understand their market segment and tailor the products according to the needs of potential customers. This is not an easy task, especially when initial orders may be small and there is a limited budget for product development. However, it must be an area of focus if the U.S. is to expand our share in this increasingly important market for imported food products.

As more foreign players enter the market, competition will center on who can provide the best quality for Japan's notoriously choosy buyers, while still meeting new cost-cutting demands from importers, distributors, and retailers coping with Japan's so-called "price destruction" trend. In fact, buyers increasingly stress superior "value" (cost + quality + special promotional characteristics) as the touchstone for success in Japan. Moreover, buyers strongly desire information on how your product can be differentiated from the competition. Thus, U.S. exporters should be cautious about over-emphasizing price competitiveness at the expense of product quality and image.

IV. CONSUMER-READY PRODUCT MARKET TRENDS AND OPPORTUNITIES

A. GENERAL JAPANESE FOOD CONSUMPTION PATTERNS

Japanese food consumption is marked by a relative openness to foreign products and a strong interest in things international. Most kinds of international cuisine can be found in Japan, especially in restaurants in the major cities. Many varieties of tropical and imported fruits, such as Florida grapefruit, California cherries, New Zealand kiwifruit, and Hawaiian papayas are readily available in supermarkets and department stores, as are imported alcoholic beverages ranging from Kentucky Bourbon to Chinese beer to Russian vodka to California sake.

In the short term, trends in Japanese food consumption, particularly of foreign cuisine, might be considered "faddish." For example, in Japan's "ethnic" restaurants, various types of hot and spicy food such as Korean and Mexican became popular several years ago, but were surpassed in popularity by French cuisine. Yet in 1997, high-

class French restaurant sales were down 5% to 194 billion (\$1.5 million), while an Italian food is boom has swept the nation, dramatically increasing sales of pasta, sauces, and related products. In 1997, Italian restaurant sales were up 5% to 218 billion (\$1.7 million).

While such food crazes are generally short lived, it is fair to say that the Japanese diet has changed significantly over the last few decades. For example, olive oil, various ethnic spices, and tortilla chips, once available only in department stores and specialty shops, are now routinely available in supermarkets. Consumers are introduced to new tastes while eating out, and will often want to make the foods themselves at home. Increased buying power, a virtual flood of media information on new food products, and the growing numbers of Japanese citizens traveling abroad, have contributed greatly to this trend. Young consumers exhibit a remarkably different set of tastes and preferences than their parents or grandparents, and they have far greater spending power than their elders did at a similar age. Fast food, convenience stores and even discount supermarkets increasingly dominate the landscape.

B. HMR AND THE BLURRING OF RETAIL AND FOOD SERVICE

Home Meal Replacements (HMR), defined as ready-to-cook, ready-to-heat, or ready-to-eat take-out meals, have caught Japanese consumers' attention, and sales continue to outpace other food categories in both retail and food service. Total HMR sales reached ¥6.3 trillion (\$52.5 billion) in 1997, up 7% from 1996. Take-out meals continue to be a growing subsector of the food service industry, with 1997 cash register sales up 4% to \$43 billion. Single and elderly household numbers are increasing, and HMR is becoming a popular alternative to traditionally prepared meals. In fact, 75% of the HMR market is supported by single households, while 38% of people over 55 years of age are turning more to home meal replacements. In response to this demand, several key food service and retail entities are simultaneously developing HMR/take-out concepts and menus, thus blurring the lines between retail and food service.

Japanese convenience store chains are becoming major outlets for HMR. The top three convenience store chains, Seven Eleven, Family Mart, and Lawson -- with a total of 11,800 outlets throughout Japan -- have become major HMR suppliers. Total convenience store HMR sales reached close to ¥100 billion (\$800 million) in 1997. In response to the continuing drop in traditional food sales totals, Japanese supermarkets are also beginning to look to HMR as a marketing strategy that will deliver solid results. As in the U.S., the retail trend in Japan is expected to move away from providing labor-intensive, "food preparations" and toward providing "complete meals." In turn, as Japanese consumers become more familiar with the high-quality, value-added HMR from the U.S., an increasing demand for the premium food products featured in HMR dishes can be expected.

C. THE RETAIL/WHOLESALE SYSTEM

A stagnant economy and failures of major financial institutions caused Japanese consumers to tighten their purse strings in 1997. Ministry of International Trade Industry figures showed that sales at department stores and supermarkets nationwide dropped 1.5% to ¥23.41 trillion (\$184.3 billion) in 1997, the sixth straight year of a decrease. Retail sales continued to drop after the April increase in the consumption tax. Sales at supermarkets nationwide declined 7% year-on-year in December, the largest drop since the Japan Chain Stores Association started the survey in July 1976. Sales at department stores nationwide slipped 5.7% in December, the largest fall for what is the stores' busiest month since a 6.2% year-on-year decline in 1993, according to the Japan Department Stores Association. It was the ninth straight month of decline since the April tax increase. Foodstuff revenues declined at supermarkets, due to lower vegetable prices. Department stores were also hurt as corporate clients spent

less for winter gifts. For all of calendar 1997, supermarket sales dropped 2.8% year on year. Department store sales declined 1.9% against 1996 sales figures.

Other factors besides weaker consumer spending were responsible for the drop in department store sales. Relaxation in the Large-Scale Retail Store Law (LRSL) encouraged retailers to actively open new stores. The LRSL, designed in part to protect local merchants from large retail competition, continues to challenge foreign investors by limiting the establishment, expansion, and business operations of large Japanese stores, which are most likely to serve as distributors of imported products. The Law will be eliminated starting in JFY2000, and replaced by a new store location law emphasizing the protection of the living environment rather than the protection of small business. As a result, the expansion in sales-floor space triggered a decline in sales at existing stores. Analysts predict that recovery will take some time.

According to a report by the Ministry of International Trade and Industry, in 1997 the number of small and medium-sized retail shops with 49 employees or less fell 5.5 percent between 1994 and 1997, while large stores with 50 employees or more increased 11.2 percent. The report also shows that the number of secondary wholesalers — intermediate dealers connecting prime wholesalers with retailers — decreased 25 percent from 1994 to 1997, reflecting an ongoing rationalization of the Japanese distribution system.

D. CONVENIENCE STORES

According to a leading financial source, after a period of rapid expansion, Japan's convenience-store sector is losing steam. While the number of convenience stores rose to 35,308 in fiscal 1997, an increase of 7.9%, it was the slowest growth since 1974.

Combined sales at the 67 chains rose 10% in fiscal 1997, to ¥6.09 trillion (\$43.19 billion). Same-store sales rose only 0.3%, however, the third straight year of nearly flat growth. Chains face intensifying competition as well as a dwindling supply of suitable store locations. The three leading chains - Seven Eleven Japan Co., Lawson Inc. and FamilyMart Co. - opened 1,339 outlets in fiscal 1997, 69 fewer than a year earlier. This fiscal year, the three plan to open 1,158 stores. Industry leader Seven Eleven opened 600 outlets in fiscal 1997 but closed 160, for a 10% year-on-year drop in net openings. Japan's convenience-store market is rapidly approaching saturation.

Typically, the product range at convenience stores is focused on ready-to-eat foods and daily necessities, although some handle a small amount of fresh vegetables and meats. Due to limited space, convenience stores can only handle a few brands per item. Product performance is reviewed continuously, and slow moving products are replaced quickly, ensuring the highest turnover possible.

Seven-Eleven, the largest operator of convenience stores in Japan, currently imports less than 5% of packaged processed food sales.

As perceived by Seven-Eleven, following are some of the most important issues faced by foreign suppliers looking to supply packaged processed foods to convenience stores:

- Modifying product taste/specifications to fit the tastes of Japanese consumers
- Shorten delivery time to ensure freshness
- Update and introduce new products frequently

E. FOOD SERVICE

1. MARKET SITUATION

Japan's large and diverse food service industry is a prime target for U.S. exporters of food, beverage and fish products. This \$355 billion market puts the Japanese food service industry, serving a population of half the size of the U.S., ahead of the \$283 billion U.S. food service industry. Food costs in Japan's food service industry totaled \$111 billion or 36.4 percent of total cash register sales in 1997. Imported foods accounted for approximately 30 percent of total food costs, or approximately \$28 billion.

2. MARKET DESCRIPTION

Japan's food market is statistically divided into two parts: 1) "*naishoku*" or home-meals (meals cooked at home, i.e., retail); and 2) "*gaishoku*" or meals not prepared at home, including restaurants, take out, home delivery, and institutional meals (i.e., food service). The food service sector is also referred to as the Hotels, Restaurants, and Institutional (HRI) sector.

Seven of the top-ten food service companies serve Western style meals. This is good news for U.S. suppliers. Many U.S. food service suppliers will be able to market products they already handle in the U.S. and will be able to sell a variety of other products after making needed modifications. Restaurants are under intense pressure to reduce menu prices in an effort to attract customers and keep up with the competition. This pressure is forcing companies to reduce food inputs costs, which in many cases means going overseas.

Looking down the list of leading fast food restaurants in Japan, one might think for a moment that they are back in the U.S. Familiar names such as McDonalds, Kentucky Fried Chicken, Mister Donut, Denny's, Dominos Pizza, Subway and many others are leaders in their various market niches. Total sales in Japan's fast food sub-sector were ¥2.1 trillion (\$17.5 billion) or 5.3 percent of total food service industry sales in 1997.

The importance of the food service industry within Japan's overall economy has also increased over the years and now accounts for 6.5 percent of Japan's total gross domestic product. In terms of total sales, the Japanese food service sector is maturing in the 1990s. The rapid growth of the 70s and 80s is clearly dampened by the current murky domestic economic climate. However, therein lies the silver lining for energetic U.S. agricultural product exporters. Although overall industry growth is projected to be modest, imported food is widely expected to play an increasingly important role. Just the size of the import market alone underscores the enormous potential to supply products from the U.S.

A number of factors point toward the Japanese food service industry increasing their dependence on imported foodstuffs in the near term.

- Declining Japanese agricultural production: Domestic production of products like vegetables, pork and poultry are expected to decline rapidly over the next ten years as the average age of farmers in Japan increases.

- Comparative advantage of U.S. producers: Domestic producers are able to satisfy niche markets very well. However, large chain restaurants are having an increasingly difficult time procuring large volumes of

products domestically. U.S. suppliers are also in a strong position to provide not only large volumes, but a constant supply with consistent quality.

-Growth in Western-style meals: Japanese restaurants serving Western-style meals are projected to continue growing. Products in demand include: beef, pork, chicken, pizza fixings, vegetables, wine and seafood products.

-High domestic food processing costs: A number of Japanese companies have invested in processing facilities in various countries throughout the world. With the high cost of land, capital, and labor in Japan, domestic production costs are not expected to decline any time soon.

In 1997 family restaurants accelerated the rate at which they are expanding. Skylark, Royal, Denny's Japan, Coco's Japan, and Western (Seiyoh) Food Systems, five major family restaurant chains, announced in 1997 plans for 207 additional restaurants -- a 60% increase over the plans for 1996. A representative from Skylark has boldly projected that within four years we will see family restaurants grow by 1,000 locations. Because of the continuing drop in land prices, family restaurants are moving into downtown locations, competing with fast food restaurants.

Competition between family-style restaurants is quite keen, due to the increase in total number of stores. In order to survive in the industry, restaurants are seeking to differentiate themselves from the competition. Restaurants are looking for ideas that will add value to their business. For example, large chains have been trying to attract customers by offering healthy food and organic menus. Another recent trend for chain restaurants is serving bread hot from the oven. Such stores are called bakery restaurants. In addition, there is a trend toward single-theme, large-size restaurants with specialty menus. For example, a Japanese-style beef restaurant now can offer a menu with over 30 different kinds of beef preparations.

An overview of family restaurant-related consumer preferences includes the following: Japanese consumers demand more and better service, good taste, reasonable prices, good atmosphere, healthy food, and menu variety. Salad bars and buffets are gaining in popularity. Also, consumers are moving away from chain restaurants' late-night service and noisy atmosphere.

Western-style family restaurants are excellent targets for U.S. exporters. They are generally more receptive to using imported food products than traditional Japanese style restaurants because their menus are more international in nature. In addition, the fact that many have centralized buying departments makes it easier to deal in substantial quantities at one time.

Western-style family restaurants are major consumers of imported beef, chicken, seafood, pork, pasta, french fries, corn, carrots, and peas. Beef in particular, from both the U.S. and Australia, are featured items on most Western style family restaurant menus.

3. THE HOME MEAL REPLACEMENT BOOM

The consumer-oriented U.S. agricultural exporter should take a good look at the under served takeout portion of the Japanese Hotel, Restaurant, and Institution (HRI) sector. A look into this market reveals extraordinary pent-up demand waiting to be mined. For instance, Japan is now experiencing an Home Meal Replacement (HMR) boom. In 1997, Japan's HMR market posted a 7% growth rate, and in 1998 double-digit growth is expected.

According to the Japanese Ministry of Agriculture, Forestry, and Fisheries (MAFF), eating home-cooked meals will decrease, and carry-out and restaurant expenditures will post double-digit growth. Factors affecting this projection include GDP, household food expenditure (at home, carry-out, restaurant), demographic changes, cost of living, etc. From these factors, MAFF has considered the future impact of GDP per capita growth ranging from 1% to 5%. From this analysis they have concluded that if future GDP growth surpasses 4%, the consumption of home-cooked meals will fall below the 1995 level. Conversely, in the same economic environment, carry-out meals and restaurant-dining will greatly increase. Should the GDP grow by 1% by 2005, eating out will increase by only 14.9% while a 5% GDP increase will result in 53.1% surge in money spent on restaurant dining. At the same time, the growth of home-cooked meals will remain flat, at best. As for carry-out meals, if GDP grows by 5%, a 116.2% increase in this market segment is expected. Thus, we can see an inverse relationship between GDP growth and the consumption of home-cooked meals.

F. THE MARKET FOR FROZEN FOOD PRODUCTS AND THE TREND TOWARD HOME MEAL REPLACEMENTS (HMR)

Japan is the largest market in the world for exports of U.S. frozen food products. In 1997 Japan's frozen food imports from the U.S. reached \$390 million, a 3% growth over 1996 totals. At the same time, the market in Japan for frozen prepared meals is just beginning to be tapped by U.S. exporters. In particular, frozen foods present a tremendous opportunity for sales from the United States to the Japanese food service industry, especially take-out meals. Just as U.S. worldwide exports of frozen HMR exploded by 47% in 1997 to \$120 million, Japan's frozen prepared meal market is expected to grow both in domestic production and in imports.

The growth of frozen food sales in Japan largely can be contributed to the growth in imported frozen foods. For instance, the Japanese consumer is showing a growing interest in frozen, certified organic vegetables sourced from foreign countries. In response to the consumer trend toward easy-to-prepare meals, several Japanese frozen food processors have stepped up production of meal components. Frozen noodle production in Japan grew to \$331 million in 1997 (up 26%), while frozen bread dough and frozen veal production both recorded 38% growth to \$140 million and \$430 million respectively.

The more westernized the Japanese lifestyle becomes, the more indistinct the differences become between homemade cooking, meals served at restaurants, and ready-made meals. As more and more women pursue careers, and the size of the family unit decreases, demand for high-quality, meal solutions is expected to grow. Nichirei, one of Japan's top frozen food processors, has mounted a campaign to educate consumers on how to prepare quasi-homemade hot meals more easily — specifically for those “on-the-go.” Following the U.S. trend toward “ready meals,” Nichirei has marketed a series of Western-style dinners that chefs at Western restaurants would recommend. Intrinsic to the promoting HMR is demonstrating that consumers will be able to prepare restaurant-quality meals quickly and efficiently.

For the U.S. producer of frozen meal components, HMR offers a unique opportunity for retail/food service cross-merchandising. The Japanese consumer is demanding high-value food products, and HMR brings value-added products closer to consumer needs. That is, HMR is an important opportunity for U.S. exporters of high-value, frozen retort food — products to which value can be added at store sites in Japan. Moreover, frozen HMR meal components provide a new opportunity for U.S. exporters to adjust their products to meet Japanese consumers' tastes.

G. HEALTHY, NATURAL, AND ORGANIC FOODS

1) Healthy Foods

Consumers are increasingly interested in eating a well-balanced diet because of worries about health. In addition, they are looking for specific characteristics in healthy foods (e.g., low-fat, high-fiber, low-calorie, and calcium-rich). In selecting health foods, consumers consider taste, packaging, safety, and confidence in the product and manufacturer. Consumers' psychological resistance to imported products is declining, but they prefer information on the labels of imported products to be similar to that of domestically produced products.

This renewed interest in health foods is attributable to an increasing awareness of nutritional deficiencies in the modern Japanese diet. For instance, a report published by the Japanese Ministry of Health and Welfare showed that average daily fiber intake has fallen by nearly 25% since the 1950s. The report also expressed concern over low levels of calcium, iron and beta carotene in the Japanese diet. For example, a typical Japanese diet contains only 2.5 milligrams of beta carotene per day, compared to a recommended daily intake of 6 milligrams per day.

Others factors which have prompted the widespread adoption of a health-oriented life style are ever increasing medical costs, and the “greying” of Japan. While the Japanese population is stable in terms of number, it is aging at a rapid pace due to the low birth rate and the highest life expectancy in the world (82.9 years for women, 76.5 years for men). Persons age 60 and over account for over 20% of the population. For the U.S. exporter of nutritional foods, all these factors make for a very attractive and viable market.

In 1997, the total retail market size of the nutritional food market in Japan was \$6 billion, of which vitamins held only a 17% share or about \$1 billion. In the U.S., the corresponding figure for vitamin intake was \$7.9 billion or 46.5% of a \$17.0 billion market -- 8 times larger than Japan. There are now over 5,000 “health” food products on the Japanese market. According to the Japan Health and Nutritional Food Association, as of 1996, 43 registered categories comprise 1,218 kinds of nutritional foods in Japan. Over the next few years, most analysts expect the market to grow by as much as 10% per year.

Effective April 1, 1997 Japan's Ministry of Health and Welfare (MHW) issued an Administrative Notice stating that some vitamins would be regulated as foods — not as medicines. Affected vitamins are: A, B1, B2, C, D, E, and Niacin. The new regulations include several important liberalization features: liberalized vitamins can be sold without any Recommended Daily Allowance limit; liberalized vitamins can be sold in any retail format, including convenience stores and supermarkets; and liberalized vitamins can be sold in any shape or form, including tablets and capsules.

As the above vitamins will be sold under the Food Sanitation Law and not the Pharmaceutical Affairs Law, they must meet certain labeling requirements common to all foods. First, it must be clearly noted on the inner and outer box that the product is a “food.” Second, companies are not permitted to mention medical efficacy on any marketing materials associated with the products.

These new regulations are a huge step toward a more liberalized vitamin and dietary supplement market in Japan. The removal of “shape” regulations greatly facilitates access to this market for U.S. companies. The expansion of distribution of the “food” category and reduction of the “drug” category is hopefully the start of a larger liberalization. On April 1, 1998, MHW further liberalized the definitions of “herbal” and “mineral” dietary

supplements. Similar to vitamins, there will be no Recommended Daily Allowance limit, there will be no shape restrictions, and products can be sold in any retail format.

2) Natural and Organic Food Products

Currently there is a movement in Japan toward healthy, good-for-you, high-fiber, low-fat, all-natural products, of which organics is one of the principal drivers. Increasingly, mainstream food companies offer the same or similar healthy products available almost exclusively in natural food stores. A strategic approach to marketing natural foods in Japan requires close attention to the U.S.'s comparative advantages in food quality, hence safety, management systems.

Japanese consumers often confuse the issues of food safety and organic food production. To the contrary, U.S. organic products should be marketed as a production system choice, and not as a food safety issue. The label "organic" does not necessarily mean "safer." On the other hand, the excellence of the U.S. organic food production system reflects well upon the food quality management systems that are presently emerging U.S. agriculture as a whole. Therefore U.S. agriculture, through the natural foods movement, organics movement, and the movement toward high-quality systems, is able to demonstrate to the Japanese consumer the continuity of quality from farm to table.

According to a leading financial news source, in 1997 the market for organic food products in Japan was estimated to be between ¥150 billion and ¥200 billion (\$1.2-1.7 billion at ¥121 to the dollar). The market for organic produce in the United States has been growing at an annual rate of 20%. Some people believe the Japanese market is also set to expand at this pace. Industry representatives believe that the organic food market in Japan will grow to an estimated \$2.6 billion by 2000. Currently, imports account for only 1 percent of the organic food market, pointing to the tremendous potential for U.S. exporters of organic foods.

It is the perception of quality that many experts believe drives the organics market. The Japanese appreciate organics partly because they tend to be very quality conscious. More important, however, is that the key word "organic" seems to be changing Japanese consumers' long-held perception that domestic produce is safe while that from overseas is not. An increasing number of manufacturers, therefore, are trying to win consumers' trust by obtaining product certification from the United States and other countries with strict inspection standards and well-established certification systems in place.

No government body — and only a few third-party organizations — exists in Japan to certify organic food. When a company simply affixes labels such as "reduced pesticides" or "no pesticides" to its products without any certification, the products generally do not win consumers' trust. Complicating matters for the Japanese consumer, eight prefectures, including Tokyo, have independently introduced standards and certification schemes. Nearly 20 other prefectures are preparing to do so. In each case, the aim is to supplement the Japanese Government's general guidelines with standards tailored to the special characteristics of the production area in question. The Ministry of Agriculture, Forestry, and Fisheries is similarly considering establishing an organic food inspection and certification system within Japan. The Ministry hopes to have such a system in place by the end of fiscal year 1999.

H. GIFT FOOD ITEMS

Twice every year, once at mid-summer (*o-chugen*), and again at the end of the year (*o-seibo*), the people of Japan

focus for a short period on a tradition they excel at: giving gifts. Based on traditions that go back hundreds of years, social and business etiquette requires that each person give gifts to family members, friends, teachers, and particularly business relations as a sign of appreciation for help and guidance received during the year. In modern Japan, the year-end gift giving season, *o-seibo*, coincides with Christmas, a major gift occasion in Japan in its own right.

In the current sour economy, however, shoppers reportedly have grown cautious as thrift and price scrutiny have replaced the abandon of the boom years. Regardless of the state of the economy, however, presenting *o-chugen* and *o-seibo* gifts to business associates, family and friends remains obligatory from the standpoint of social and business etiquette.

With less money to spend but the same number of obligatory gifts to buy, consumers have turned to lower priced, practical gifts. According to one merchant, consumers are returning the original gift concept of giving items that are necessary for daily life, stating, "The days in which people competed to give unique and luxurious gifts are gone." Shopping behavior during last year's *o-seibo* period was summed up by researchers as focusing on "3J" products, the 3 J's being: "*jimi*" (simple), "*jitsuyoteki*" (practical), and "*juryo*" (heavy, substantial).

The trend toward practical gift products may be seen in a positive light for the food gift business. An eminently useful product sector and priced in the moderate range (around ¥3,000, or \$21 per gift pack), food gifts are a good alternative to more extravagant items. Food gifts are traditionally some of the most popular gift products with beer, soy sauce, gourmet cooking oil, ham, liquor, and confections leading the way.

In a 1997 survey of 300 housewives living in Tokyo and Osaka conducted by Ajinomoto General Foods Inc., the most popular summer gift food items to send were beer, coffee, and "*somen*" noodles. On the other hand, the most popular food gifts to receive were beer, seasonings, cooking oil, and coffee. Of the 300 surveyed, 95% responded that they would buy gifts this year.

V. DISTRIBUTION SYSTEMS FOR CONSUMER-READY FOOD PRODUCTS

A. OVERVIEW

Japan's distribution system is complex, labor-intensive, and filled with seeming redundancy. It is expensive and accounts for much of the differential between prices in Japan and the rest of the world. The 1990s have been a difficult time for the distribution industry as consumer demand and official recognition of the need to make the economy more efficient have precipitated a number of changes. Nevertheless, the traditional system endures and continues to be not merely a drag on the domestic economy, but a formidable barrier to imports of goods and services, as well.

Difficulties with Japanese distribution are partly socio-cultural in nature. Many Japanese are hesitant to disrupt longstanding relationships with suppliers -- even when a U.S. supplier can offer a superior product at a lower price. On the one hand, many retailers and wholesalers report that they fear retaliation from existing Japanese suppliers if they switch to new overseas sources. At the same time, they may also be concerned that a foreign supplier will not make timely shipments or may lack adequate after-sales service ability, for which Japanese expectations run very high. These doubts stem in part from a traditional reluctance to do business with strangers, who could

introduce uncertainty into predictable, existing business relationships. A clearly-demonstrated commitment to develop long-term relationships with Japanese business people is crucial to overcome this reluctance. An established presence in the market (if only through a knowledgeable and committed agent) is also a decided advantage in winning trust.

About half of all consumer purchases are made at neighborhood "mom and pop" stores (with five or fewer employees), and these stores rarely carry imported goods. In fact, they often have strong ties to major domestic manufacturers, including financial accommodations, equity investments, and/or exclusive marketing arrangements. These small shops do not have sufficient space to maintain large inventories and rely on expensive small-lot, on-demand deliveries. The economic stagnation since the collapse of the "bubble" nearly ten years ago has taken a toll on small retailers. Their numbers are declining, as convenience stores, self-service discount stores, and "superstores" mushroom. The ascendance of more efficient retailers is also helping to reduce the layers in the distribution system and make imported goods more price competitive.

Imported consumer goods have been traditionally sold at larger outlets such as department stores and discount houses. The 1990s have also witnessed dramatic growth in specialty retailers, notably foreign names. Hand-in-hand with this development, direct importing -- bypassing trading houses and as many other intermediaries as possible - has become increasingly popular as a way to reduce costs.

In short, the face of Japanese distribution is changing. Large retailers, such as national supermarkets, convenience stores, and discount stores, are pursuing more efficient distribution channels in response to recent consumer demand for value. This in turn is causing a shift in the balance of power in retail distribution away from large Japanese manufacturers and towards large retailers. These large retailers are lowering costs by increasing direct transaction with manufacturers, and/or by limiting the number of wholesalers with which they do business.

B. DISTRIBUTION CHANNELS

1. PROCESSED FOODS AND BEVERAGES

Although wholesalers and actual distribution channels in Japan vary depending on the type of processed food product (i.e., canned, frozen goods, dried goods, etc.), the basic flow of products is similar. Typically, most types of processed foods/beverages pass through multiple layers of wholesalers before arriving at retailers.

This flow of goods between wholesalers has been a major, if not the most important, factor behind the complexity and inefficiency in Japanese retail distribution of processed foods/beverages. However, recent socio-economic changes have brought intense price competition at the retail level, leading to significant efforts by retailers with large purchasing power to streamline distribution and eliminate layers from the flow of goods.

For processed foods/beverages, many of the national supermarkets and the larger regional supermarket chains are promoting direct transaction with manufacturers and/or are limiting the number of wholesalers with which they do business. In the latter case, retailers designate a group of wholesalers through which all other wholesalers are required to supply products. By limiting their number of wholesalers, retailers hope to increase the efficiency of physical distribution and to decrease the burden on retailers' warehousing centers.

For example, Seiyu, one of the largest national supermarket chains, now deals with only four wholesalers for

processed foods in comparison to over 100 wholesalers years ago. It currently procures nearly 40% of processed foods/beverages directly from suppliers, by-passing wholesalers.

Daiei, the largest national supermarket, also would like to purchase more and more processed foods directly from manufacturers, assuming that price and safety standards are met. It has also established regional distribution centers/warehouses for consolidation of products before shipment to each of its outlets. In areas where it does not have a regional warehouse, products from multiple wholesalers are consolidated at designated wholesalers' warehouses before shipment.

Convenience stores are also attempting to streamline distribution by limiting the number of wholesalers with which they deal. These stores, which are among the largest retailers in Japan, have the purchasing power to demand efficient distribution. Yet convenience stores substantially rely on wholesalers for multiple small-lot deliveries a day, as manufacturers cannot match such services. Typically, deli foods, obento (prepared lunch boxes) products, and other fresh foods are delivered three times a day, while non-fresh foods are delivered three times or more a week. Lawson, Japan's second largest convenience store chain, even requires daily delivery of non-fresh products such as snacks, confectioneries, beverages, and packaged dried foods.

What is more, Seven Eleven designates one regional wholesaler for every 200 to 300 stores to deliver goods to its outlets. All other wholesalers must supply products through these designated wholesalers. In this manner, Seven Eleven has been able to reduce the number of trucks delivering to each outlet to less than 10 per day, compared to over 70 when it first began retailing. Lawson has 32 warehousing centers for consolidation of products for delivery. Although the chain deals almost exclusively with wholesalers for food products, it has been able to reduce to approximately 5 per day the number of deliveries per outlet.

In contrast, smaller retailers, such as the smaller regional supermarkets, individually-owned stores and food specialty stores, have not been able to increase efficiency in their distribution channels. They do not have sufficient purchasing power to demand direct transactions with manufacturers nor to limit the number of wholesalers which make deliveries to their stores. Furthermore, these smaller stores rely on wholesalers for longer credit terms than those provided by manufacturers, for acceptance of unsold inventory, and for product range and shelving advice. The latter is important for these small retailers, many of which do not have access to Point-of-Sale (POS) technology. Wholesalers, which handle products from multiple manufacturers, are able to provide comprehensive advice to these retailers for various products.

Department stores have followed a similar course. While some department stores may have large purchase volume, they continue to rely on wholesalers and manufacturers to accept returns of unsold goods. This in turn compromises department stores' position in the distribution system. Department stores are unable to take on the risk of unsold goods, as they offer a large volume of high quality products.

For imported, processed foods/beverages, the distribution flow is similar to that for domestic products, with the exception that trading companies typically import the products before they are distributed domestically through a wholesaler network. However, large retailers, such as national supermarkets and convenience stores often import directly to procure products according to their own standards and specifications. In turn, these large retailers work with foreign suppliers to develop food products that meet their needs. For example, Ito-Yokado, the second largest national supermarket, imports most of its food products directly, while Seiyu imports nearly half of its products directly. Daiei imports its private brands directly from suppliers.

In contrast, convenience stores do not handle a wide range of imported processed foods, as space is quite limited. Since these stores limit the number of brands handled, processed food products have to achieve a high turnover rate in order to maintain their place on the shelf. Low performing brands are quickly replaced by other products.

Family Mart, a major convenience store chain, directly imports private brand products which it has developed overseas. Seven Eleven, which estimates that imports account for approximately 5-6% of its food sales, uses a trading company or wholesaler to import processed food products. Lawson, on the other hand, gets most of its imported food products through Daiei, its parent company.

The actual wholesalers involved in the distribution process described above differ by product type. For example, wholesalers of alcoholic beverages are limited to those wholesalers with liquor wholesale licenses. Wholesalers of frozen and fresh foods must have the necessary refrigeration facilities, including refrigerated trucks and warehouses. The typical classifications for processed food wholesalers in Japan are as follows, although large wholesalers handle most product types:

- * Frozen processed foods
- * Sweets and breads
- * Dried goods
- * Alcoholic beverages
- * Japanese tea
- * Non-alcoholic beverages
- * Miso and soy sauce
- * Canned goods
- * Sugar

C. BUSINESS PRACTICES

1. ORDERING

Many, if not most, large retailers, including national supermarkets, the larger regional supermarkets, and convenience stores, place orders on-line using electronic ordering systems. The smaller stores, including specialty food stores and other small mom 'n pop stores, tend not to have on-line ordering systems. A major food wholesaler estimates that 50% of orders from these stores are placed to wholesalers by facsimile, 40% over the telephone, and 10% through personal visits. Wholesalers recommend orders be placed through facsimile to avoid mistakes and speed order processing.

2. DELIVERY

National supermarkets and convenience stores have their own central and regional distribution centers to which manufacturers or wholesalers deliver products. From these centers, consolidated deliveries of a wide variety of products are trucked to each outlet. Typically, convenience stores deliver fresh food products such as deli-type foods and lunch boxes to each of their stores three times a day. Other products are usually delivered three times a week on average.

In 1995, Lawson began everyday delivery of all products to each outlet in order to cut lead time and avoid out-of-stock situations, especially during the weekends. Under its new physical distribution system, outlets place orders to Lawson headquarters by noon everyday. The orders are then passed on to wholesalers which deliver products to Lawson's distribution center by 7:00 pm. Products are consolidated and sent out to each outlet the same night between 10 pm and 4 am.

3. PRICING STRUCTURE

Pricing structure for domestic food products varies by product type and by type of retailer. Wholesale prices to national supermarkets and discount stores tend to be the lowest due to their large purchase volume and comparatively lower pricing strategy. Wholesale prices to the small retailers, on the other hand, tend to be the highest. In spite of their high purchasing volume, wholesale prices to department and convenience stores fall somewhere in between due to their pricing strategy and reliance on wholesalers for frequent delivery and acceptance of unsold goods.

For processed foods, primary wholesalers typically purchase products from manufacturers at 65% to 70% of price to consumer, while retailers purchase products from these wholesalers at prices ranging from 75% to 80% of price to consumers. For fresh vegetables and seafood, average purchase prices are slightly lower due to their shorter shelf lives.

VI. SUMMARY STATISTICS

(U.S. Dollars, CY1997)

Agricultural Imports (Total/\$Billion) 1/, 2/	\$66.6
Agricultural Imports as a Percent of Total Imports	19.6%
U.S. Market Share of Total Agricultural Imports	27.1%
U.S. Consumer-Ready Food Product Exports (\$Million) 2/, 3/	\$7,572
Agricultural Trade Balance with U.S. (\$Billion) 1/, 2/	-\$13.8
Major Metropolitan Areas 4/	209
Total Population (million)	126.2
Population Growth Rate 5/	1.0%
Urban Population (million) 5/	96
Urban Population Growth 5/	0.6%
Percent of Female Population Employed	42.8%
Per Capita Gross Domestic Product 2/	\$33,734
Per Capita Food Expenditures 2/	\$8,540

1/ Includes forest products

2/ Exchange Rate: ¥121/\$1

3/ Total Agriculture less forest and bulk products

4/ Population in excess of 100,000

5/ 1997 estimate

For additional information about U.S. agricultural, food, forestry and fishery product exports to Japan and other countries, please see the Foreign Agricultural Service Homepage at <http://www.fas.usda.gov>. Japan's Ministry of Finance maintains a webpage that describes import clearance and other procedures in detail. To access this site, contact <http://www.mof.go.jp>.